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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1951

No. 650-651

MOLLY A. HARKNESS,
Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FLOYD J. HARKNESS,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

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To the Honorable Fred M. Vinson, Chief Justice of the Supreme Court of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

Molly A. Harkness and Floyd J. Harkness, petitioners herein, respectfully pray that a writ of certiorari issue to review a decision of the United States Court of Appeals rendered December 28, 1951. (R. 321-331.) A petition for rehearing was filed on January 25, 1952, and the same was denied by the Court of Appeals on January 29, 1952. (R. 332.) The judgment of the Court of Appeals affirmed decisions of the Tax Court of the United States against petitioners and in favor of respondent. The decisions of the Tax Court were promulgated on December 22, 1949. (R. 249.) These cases were brought to the Court of Appeals under the provisions of the Internal Revenue Code, 26 U.S.C.A. 1141(a), 1142, and were there consolidated for the purposes of record, brief, argument and opinion. (R. 316-318.)

OPINIONS BELOW.

The findings of fact, opinion and decisions of the Tax Court are reported in 13 T. C. 1039, and are also set forth in the Record at pages 249 to 281. The opinion of the Court of Appeals is reported in 193 F. 2d 655. This opinion appears in the Record at pages 322 to 331.

JURISDICTION.

The jurisdiction of this Court is invoked under the provisions of the Judicial Code, 28 U.S.C.A. 1254(1), and the Internal Revenue Code, 26 U.S.C.A. 1141(a). The petitioners also rely on Rule 38, Par. 5(b), of this Court for their grounds upon which this petition is made.

STATUTES AND REGULATION.

The statutes involved are Sections 11, 22(a), 181, 182 and 3797 of the Internal Revenue Code (26 U.S.C.A. 11, 22, 181, 182, 3797). The regulation involved is 111, Sec. 29.22(a)-1. The pertinent portions of these statutes and regulation are set forth in the Appendix.

STATEMENT OF THE MATTER INVOLVED IN THIS PETITION.

This is a family partnership income tax case. It has its origin in the desire of petitioner, Floyd J. Harkness, to bring his son and son-in-law into the family business.

The petitioners are husband and wife. They are residents of Fresno, Fresno County, California. (R. 105.) Whether the wife should be recognized as a partner is not an issue in this case. (13 T. C. 1051.)

The partners to whom the respondent refused recognition for tax purposes did not contribute services to the partnership during the tax year in question, but

they did contribute capital of which they were "the true owners". In addition, they exercised control over that capital, and thus influenced the conduct of the partnership. They were, therefore, responsible for the production of income during the year in question. These partners are the adult children of the petitioners and the income derived by them from the partnership was used by them for their own purposes and not for those of petitioners. (*Commissioner v. Culbertson* (1949), 337 U.S. 733, 93 L.Ed. 1659.)

On August 21, 1947, the respondent determined deficiencies in income tax liability for the taxable year ended December 31, 1943, against petitioners, in the aggregate amount of One Hundred Thirty Thousand One Hundred Forty-eight Dollars and Ninety-one Cents ($130,148.91). (R. 250.)

This determination arose by reason of the inclusion by the respondent in the petitioners' taxable income for the taxable year 1943, on a community property basis, of all the income from the operation of a partnership composed of petitioners, their son, Floyd J. Harkness, Jr., and their daughter, Harriet Harkness Colgate. (R. 272, 273.) This partnership does business under the firm name and style of "United Packing Co." (R. 115.) During the taxable year in question, each one of the partners owned a one-fourth undivided interest in the partnership. (R. 15-16.)

Respondent's notices of deficiencies stated that the partnership would not be recognized for tax purposes because petitioners' children "contributed no capital ***originating with themselves, rendered no services to***

the business, and were not required to participate in the control and management of the business". (R. 272; 13 T. C. 1050.)[1]

After the respondent had made his determination of deficiencies, petitioners applied to the Tax Court for a redetermination. The petitions were consolidated in the Tax Court for hearing. (R. 83.) The petitions were heard on January 11, 1949. (R. 82.)

At the hearing the respondent relied on the presumption that his assessment of deficiencies was *prima facie* correct.[2] To overcome this presumption, petitioners offered the testimony of four interested witnesses, to-wit, Floyd J. Harkness (R. 105), one of the petitioners herein, their son, Floyd J. Harkness, Jr. (R. 225), their daughter, Harriet Harkness Colgate (R. 194), and their son-in-law William H. Colgate (R. 210). The petitioners also proffered a stipulation of facts (R. 30), and certain documentary evidence.

Petitioners' evidence was uncontradicted and undisputed, and was not referred to in the opinion of the Tax Court as being unworthy of belief, and the Tax Court based its evidentiary findings thereon. The resolution of the issue involved did not require the exercise of the Tax Court's expertness in tax matters.

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[1]This was a pre-Culbertson notice, which disregarded the issue of "intent", and was based on the discredited "vital services-original capital" test.

[2]*United States v. Rindskopf* (1882), 105 U.S. 418, 421, 26 L. Ed. 1131, 1133; Rule 32 of the Tax Court, 26 U.S.C.A. 1111.

After the hearing, the Tax Court affirmed respondent's assessment of deficiencies, and in so doing, made the following ultimate findings:

1. "During the year 1943 there was no change in the operation of United Packing Co. over prior years. The business was still completely under the control of (petitioner) Harkness, Sr." (R. 270; 13 T.C. 1049.)

2. The petitioners and their children "had no intent to join together in conducting the business of United Packing Co. as bona fide partners in 1943 and thus their partnership was not valid for tax purposes that year". (R. 273; 13 T.C. 1050.)

These ultimate findings are "wholly without warrant in fact" and result from the application of the "wrong standards for judgment". (*Commissioner v. Culbertson,* supra, 337 U.S. 752, 93 L. Ed. 1670.) It is our contention that the evidentiary or circumstantial findings of fact of the Tax Court and other evidentiary facts shown by the record, with respect to which the Tax Court made no findings,[3] compel conclusions contrary to those contained in the above-quoted ultimate findings. It is our position that petitioners were entitled, as a matter of law, to an ultimate finding to the effect that they and their children had the intent to join together in conducting the business of United Packing Co. as *bona fide*

[3]The Tax Court findings are limited to the events which preceded the formation of the partnership and to the operation of the partnership during the tax year in question.

partners in 1943 and consequently their partnership was valid for tax purposes in that year.

Our contentions, it appears to us, make it clear that we seek review of a question of law, and should our petition be granted, this Court may properly substitute its judgment for that of the Tax Court. (*Helvering v. Tex-Penn Oil Co.* (1937), 300 U.S. 481, 491, 81 L. Ed. 755, 762; *Bogardus v. Commissioner* (1937), 302 U.S. 34, 39, 82 L. Ed. 32, 36.)

The evidentiary findings and the evidentiary facts on which we rely to support our contentions are the following:[4]

A. The Evidentiary Findings.

1. *The findings with respect to the partnership business and the partners: The son and the son-in-law are qualified by experience and education to participate in the family business.*

> "Petitioners, Floyd J. Harkness and Molly A. Harkness, are individuals residing in Fresno, California. * * * Petitioners were married July 14, 1915, and have made their home in California ever since. They have two children, Floyd J. Harkness, Jr., and Harriet Harkness Colgate, born in 1918 and 1920, respectively.
>
> "Harkness, Sr., has been a grower and shipper of fruits and vegetables since 1918. Prior to 1937 he engaged in this occupation first as an employee of various concerns and then as a member of two

[4]The evidentiary findings of fact of the Tax Court are amply supported by substantial evidence, and the printed record which is presented with this petition contains all the evidence introduced in that Court.

successive partnerships operating under the name of United Packing Co. In January, 1937, petitioner bought out his partner and commenced operating the business as a sole proprietorship under the same name. Molly Harkness, as his wife, owned the assets of the business in community with him. The company specialized in packing and shipping cantaloupes, carrots, peaches, plums, nectarines and grapes. Some commodities were raised by the company itself while others were bought from farmers on a cash basis. Still other produce was packed and shipped by the company on a commission basis. For the purposes of its business United Packing Co. operated ranches and packing houses, and manufactured and stocked packing materials. Its main office was located in Fresno, but its operations covered a large area in the San Joaquin Valley extending northward 138 miles to Lodi and southward 127 miles to Arvin. At the close of 1942 the gross proceeds and net income earned by United Packing Co. amounted to $1,468,119.64 and $141,790.95, respectively.

"During the years up to 1942 Petitioners' two children were occupied primarily in obtaining an education, though each performed some services in their father's business. Harkness, Jr., attended schools until June, 1941, when he graduated from college with a major in commence. From 1934 until 1941 he worked in his father's business during the summer vacations and in 1937 he quit school for six months to help his father launch the sole proprietorship. From June, 1941, until January, 1942, he devoted his full time as an employee of United Packing Co. working as a 'regular field man' at a salary of $150 per month

plus a five per cent bonus of approximately $910. During this six months' period he also earned four to five thousand dollars in independent deals in the fruit and vegetable business. On January 12, 1942, he entered the United States Air Corps as a private. At the close of 1942 Petitioners' son still had a credit on the books of the sole proprietorship of $1,412.05 for prior services performed. He owned no substantial property outside of these earnings at that time.

"Harriet Harkness finished her schooling in June, 1942, when she graduated from college. During summer vacations she had occasionally performed secretarial services in her father's business. Harriet worked full time as a secretary at United Packing Co. from June until August, 1942, at which time she married William H. Colgate, Jr., who was then serving in the United States Army. Following her marriage she spent her time housekeeping for her husband at various military posts in the United States until October, 1944. She owned no significant amount of property at the time of her marriage.

"Harriet's husband, William Colgate, had resided in Fresno County, California, all his youth and had been an acquaintance of the Harkness family for a number of years prior to his marriage in 1942. He attended college, majoring in commerce, and during summer vacations was employed by the Peerless Pump Company, the largest supplier of irrigation pumps in the San Joaquin Valley. Colgate later quit school and worked full time for this company for nine months before enlisting in the United States Army in March, 1941. This was in keeping with

his desire to devote his career to agricultural pursuits in the Valley. As an assistant foreman aiding in the installation of extensive irrigation systems, Colgate acquired considerable knowledge of the mechanics of irrigation. After his marriage to Harriet, they were stationed at Columbus, Ohio, during the latter part of 1942 and throughout 1943." (R. 250-253; 13 T.C. 1040-1041.)

2. *The findings with respect to the reasons that dictated the decision to form the partnership: (a) The desire to procure the services of the son and the son-in-law; (b) It was essential to increase the capital of the business to provide for expansion, meet the exigencies of bad crop years and an expected decline in profits; (c) The fulfillment of promises made to the children.*

"In the fall of 1942 Harkness, Sr., became convinced that it would be advantageous to convert the operation of his fruit packing and shipping business from a sole proprietorship to a partnership composed of his wife, himself and his two children in the coming year. Many reasons dictated that decision. Primarily he desired to obtain the services of his son and son-in-law in the business. He felt that as a result of their college education and the practical experience they had gained pursuing agricultural employment in the Valley that they would make skilled, competent supervisors capable of overseeing the widespread operations of the company. Secondly, from his experience in the fruit and vegetable packing industry, Harkness believed that it was essential

to increase the capital investment in the company by allowing annual profits to remain in the business. This was necessary not only to permit payment of extensive operating expenses, to allow for expansion of the company facilities and equipment and to develop new business, but also to meet the exigencies of bad crop years when the company's income declined drastically. Furthermore, in 1942 fruit packers were anticipating a decline in profits due to labor shortages, low transportation priorities for their produce, and the probability that prices would tumble as in World War I. These circumstances only increased the need for increasing the capital reserve of United Packing Co. Yet it had been Harkness' experience in past years that to hold qualified supervisory personnel it was necessary to pay them large bonuses or percentages of profits which they invariably withdrew from the business and often used to set themselves up in competition with him, thus draining the company's capital. He felt the only way to retain profits in the company was to bring into the business persons who felt as he did. Through long discussions with Harkness, Jr., and William Colgate, Petitioner knew that they agreed with him that only a reasonable amount of the profits should be withdrawn from United Packing Co. and the rest of the net income should be allowed to accumulate in the business.

"While Harkness, Sr., was well aware that neither Floyd, Jr., nor William Colgate would be available to serve United Packing Co. for the duration of the war and he would be the only active partner in the meantime, yet he desired

them to acquire an interest in the company at this time to guarantee their future help in running the business after their release from the Army.

"Furthermore, formation of the partnership accorded with the wish of Harkness, Sr., to give his children an opportunity to make good. Even when Floyd, Jr., was a boy he and his father planned for the day when the former would be a full-fledged partner. After graduation from college in 1941 Harkness, Jr., had pressed his father to give him the status of a partner in the business, and while Harkness, Sr., had too many financial commitments to do so in that year, yet he promised his son he would make provision for him to purchase an interest in the business. Now Petitioner desired to fulfill that promise. It was long understood that if one child was given an opportunity to participate in the business, the other would be given an equal opportunity. Offering Harriet an opportunity to become a partner in his business not only fulfilled this pledge, but was a long step toward securing the eventual services of her husband which Petitioner so greatly desired." (R. 253-255; 13 T.C. 1041-1042.)

3. *The findings with respect to the consideration given to the tax saving possibilities inherent in the partnership arrangement.*

"While Harkness, Sr., consulted a lawyer concerning the feasibility of converting his business into a partnership and was thus aware of the tax-saving possibilities inherent therein, yet this fact was only a secondary consideration with him, and

he would have entered into this arrangement regardless thereof." (R. 255-256; 13 T.C. 1043.)

4. *The findings with respect to the negotiations which led to the formation of the partnership: (a) The son eagerly accepts the opportunity to buy an interest in the business; (b) The daughter is offered either the opportunity to invest in the family business or some other enterprise; (c) The daughter exercises her option to invest in the family business with the understanding that her husband is to be allowed to participate in the partnership; (d) The partnership agreement is not executed until its provisions are modified to the extent desired by the daughter.*

"During the fall of 1942 Harkness, Sr., held lengthy conversations with his son, who was stationed at a nearby airfield, regarding the proposed partnership. Harkness, Jr., eagerly accepted the chance to buy an interest in United Packing Co. for this had been his great desire for many years and assured him of full participation in the business on his return from the service. Petitioners and young Harkness then definitely planned to convert the business into a partnership starting in 1943.

"Over the same period of time Harkness, Sr., also corresponded with his daughter and offered her either the opportunity to invest in United Packing Co. or some other enterprise. Furthermore, it was understood that if she decided to come into her father's business, her husband, William Colgate, would be allowed to participate in the partnership following his release from the

Army. Harriet and William Colgate debated at length whether it was advisable for her to buy an interest in her father's business or invest elsewhere. Finally Harriet exercised her option to procure an interest in United Packing Co. after her husband determined he wanted to be associated with the United Packing Co. upon his return from the service.

"Thus, by November, 1942, Petitioners and both their children generally agreed to the formation of a partnership for the operation of United Packing Co. in the coming year, though the details of the partnership relationship had not been worked out. A 'Certificate of Co-Partnership Transacting Business under Fictitious Name' was executed on November 12, 1942, which Petitioners and young Harkness signed on that date and Harriet signed on November 28. It stated that the four were co-partners carrying on business under the name of United Packing Co. and that Harkness, Sr., was the general manager in full charge of all business operations. This certificate was published in a local paper and later filed with the county recorder of Fresno County.

"On December 31, 1942, 'Articles of Partnership,' providing the detailed terms of the proposed partnership, were drafted and met the approval of all but Harriet Colgate, who refused to sign until provisions as to the control of the business and as to purchase of a deceased partner's share were modified.

"On January 1, 1943, Petitioners transferred to United Packing Co., a partnership, most of the assets and some of the liabilities of United

Packing Co., sole proprietorship, existing on December 31, 1942, resulting in a net worth of $138,241.61 for the partnership on that date. Harkness, Jr., and Harriet Colgate each bought a one-fourth interest in the partnership for $34,560.41, equivalent to one-fourth of its net worth. To pay Harkness, Sr., for his share in the partnership, the son used $1,392.05 of the credit he had earned as compensation for prior services rendered the sole proprietorship and on January 2, 1943, signed a promissory note for the remaining $33,168.35 with interest at four per cent per annum. Harriet Colgate purchased her partnership interest from her father with a promissory note dated January 2, 1943, for $34,560.40 plus four per cent interest per annum. William Colgate joined her on the note as co-maker. No collateral was required on either note."[5]

"These transactions were reflected on the books of United Packing Co., copartnership, as of January 1, 1943. It showed assets of $142,861.03 and liabilities of $4,619.92 and a net worth of $138,-241.61. Capital of the partnership was stated to be $138,241.61 resulting from contributions of $34,560.41 each from the three Harknesses and Harriet Colgate.

"On January 4, 1943, pending acceptance by Harriet Colgate of the articles of partnership

[5]This is an erroneous conclusion of law. Each of the said notes contains the following statement: "This note is secured by my one-fourth interest in the United Packing Co. of Fresno, Cal.", (R. 119, 121) and under the terms of the partnership agreement, the children pledged the first profits derived from the business to the payment of the notes. (R. 263; 13 T.C. 1046.)

drafted on December 31, 1942, Harkness, Sr., Molly Harkness, Harkness, Jr., and Harriet Colgate signed a supplemental agreement fixing compensation and distribution of partnership profits among the partners. The salary of Harkness, Sr., as general manager of the partnership, was fixed at 75 per cent of the first $100,000 of the partnership net income. There was no provision for salaries for the other partners. The remainder of the first $100,000 of partnership net income was to be divided equally among the partners, as were any profits over that amount. Paragraph three of this supplemental agreement stated:

> " 'It is understood and agreed that the payment of the 75% of the net income as provided for, is being made to first party on account of the fact that he is the only active co-partner in said business at this particular time and will continue as such during the duration of the present war.'

"During January, 1943, Harkness, Sr., discussed with the Colgates the modifications sought by Harriet Colgate in the partnership agreement drafted on December 31, 1942. Harriet withdrew her objections when the original draft was altered to meet her demands. The reformed partnership agreement was signed by the three Harknesses on February 27, 1943, and by Harriet Colgate on March 10, 1943 * * *." (R. 256-259; 13 T.C. 1043-1044.)

5. *The findings with respect to the partnership agreement:*

The partnership agreement signed by the parties is a lengthy document and is set forth in full in the

findings of fact of the Tax Court. (R. 259-269; 13 T.C. 1044-1048.) The material and relevant provisions of the agreement may be summarized as follows:

(a) *Term.* The partnership begins on January 1, 1943, and will continue until dissolved by the mutual agreement of the parties or pursuant to the terms and conditions of the agreement. (R. 259-260; 13 T.C. 1045.)

(b) *General Manager.* Petitioner Floyd J. Harkness, Sr., is appointed general manager of the business, and, as such general manager, is given "full charge of all business operations" and has "the right to conduct the business * * * in such manner as he may desire". Included in the powers granted him are the right to borrow money and the right to sell and purchase property on behalf of the partnership. The general manager and any other partner, acting together, shall have the right to bind the partnership in "such manner or form as they deem necessary, in order to carry on the business of the partnership"; no other partner shall have the right to bind the partnership. (R. 262-263; 13 T.C. 1046.) The general manager shall have complete charge of the books of account and full charge of all money expended and collected in connection with the partnership. (R. 264-265; 13 T.C. 1046-1047.) The business transactions of the general manager on behalf of the partnership shall be binding on all the partners. The general manager shall devote as much of his time to the partnership business as he deems necessary and proper. The general manager

"will at all times use his own good judgment and best efforts and experience in carrying on said business for the best interests of all parties concerned". (R. 263-264-265; 13 T.C. 1046-1047.) The general manager will render on the first of each year a true and full statement and account of the profits and losses of said business and all other matters and transactions done and performed in connection with said business. (R. 265; 13 T.C. 1047.) The general manager shall receive for his services "a certain percentage of the net profits of said business to be agreed upon between all the partners". (R. 263; 13 T.C. 1046.)

(c) *Services and compensation of other partners.* Petitioners' children and petitioner Molly A. Harkness "shall not devote any time or attention in carrying on said business unless hereafter agreed upon by and between any three said copartners and at that time it shall be agreed upon by and between any three of said partners as to what the compensation shall be for the services" which either of the children may contribute to the partnership. (R. 264; 13 T.C. 1046.)

(d) *Capital.* Petitioners convey the assets of the family business to the partnership to the end that these assets, as well as any other property which may thereafter belong to the partnership "shall be owned equally by all the said copartners". (R. 262; 13 T.C. 1046.) The real and personal property which shall compose the capital of the partnership is described in Exhibit "A" attached to the agreement. (R. 261-262; 13 T.C. 1045.) With the consent of the general

manager and two other partners, the capital of the partnership may be increased to such sum as may be determined by them, and each of the partners shall contribute their share of the capital increase. In the event the general manager and two other partners desire to reduce the capital of the partnership, such determination shall become binding on all the partners. (R. 265; 13 T.C. 1047.)

(e) *Profits and Losses.* It is the intent and purpose of the parties that each partner shall share equally in all the profits and losses that may arise out of the partnership operations. The decision of the general manager and two other partners shall be final as to the division and withdrawal of profits and the amount that may be paid in by each partner to meet losses. (R. 268-269; 13 T.C. 1048.) The balance of net income of the partnership, after payment of compensation to the general manager "shall be equally divided between all the copartners * * * at such time or times as they may agree upon"; provided, however, that the profits which the children may be entitled to receive shall be paid to petitioner Floyd J. Harkness and applied by him first, to any advances made by him to the children, and the balance, if any, shall be used to pay the promissory notes executed by them in payment of the purchase price of their share in the business. (R. 263; 13 T.C. 1046.)

(f) *Accounts and Books.* There shall be kept at all times a complete set of books of account where all matters relating to the business of the partnership shall be recorded. (R. 264; 13 T.C. 1046.)

(g) *Acts not to be done without consent.* No partner shall sell, assign, transfer or hypothecate his interest in the partnership without first obtaining the written consent of two other partners. (R. 264; 13 T.C. 1046.) No partner shall, without the written consent of the others, enter into any bond or become bail or security for any person, or do anything whereby the capital of the partnership may be taken by execution. (R. 265; 13 T.C. 1047.)

(h) *Death, Insolvency or Retirement.* Should a partner become insolvent, the others may purchase his interest, at book, without any consideration for good will value (R. 266; 13 T.C. 1047). Should a partner die or retire, the others may purchase his interest, at book, without any consideration being given to good will value. (R. 267; 13 T.C. 1047.) The purchase price of said interest may be paid for in cash, or, at the option of the remaining partners, from the share of the profits of the business attributable to the interest of the partner who has died or retired. (R. 266-268; 13 T.C. 1047-1048.)

(i) *Disputes.* Should there be any dispute between the partners concerning the conduct of the business, then the partners shall adjust the dispute between themselves; however, the decision of the general manager and one other partner shall determine such dispute, but in the event that any partner should be dissatisfied with such decision, he shall have the right to bring legal proceedings either to dissolve the partnership or to obtain the enforcement of the terms of the agreement. (R. 268; 13 T.C. 1048.)

(j) *Accounting and division of Assets upon dissolution.* On dissolution of the partnership, the partners will make a true, just and final accounting of the business, and the assets that may remain shall be divided between them equally. (R. 269; 13 T.C. 1048.)

6. *The findings with respect to the conduct of the business under the partnership agreement: The children do not render any services, but their counsel and approval is sought in connection with the purchase of properties; problems arising in connection with the business are discussed with Harkness, Jr.*

"In February, 1943, an undivided one-half interest in a 300-acre vineyard and orchard was acquired by Harkness, Sr., Molly Harkness, Harkness, Jr. and Harriet Colgate as tenants in common. The other half interest in the ranch was acquired by Chris Sorenson and his wife. Sorenson was a supervisory employee of United Packing Co. All funds for purchase of the vineyard were supplied by United Packing Co. and the amount loaned to Sorenson was repaid to the company by him. The 50 per cent interest acquired by the Harknesses and Harriet Colgate was included as an asset of United Packing Co. and subsequent income therefrom was included in its net income. Previously on January 16, 1943, by a bill of sale the personal property on the River Ranch had been conveyed to Chris A. Sorenson and Katharine Sorenson, his wife, and 'Floyd J. Harkness, Molly A. Harkness, Harriet Harkness Colgate and Floyd J. Harkness, Jr., co-partners, doing business under the firm name and style of United Packing Co., a co-partner-

ship.' Prior to these purchases, all the partners were consulted with respect to them, and Harkness, Jr., who was familiar with the land, approved the transactions.

"* * * Harriet and William Colgate were absent from Fresno until his discharge from the armed services in October, 1944, so consequently she performed no services for United Packing Co. during the year 1943 nor did she participate in the management of its affairs.[6] Throughout the year 1943 until December, Harkness, Jr., was stationed at Hamilton Field, California, approximately six hours traveling time from Fresno, and frequently visited the company's office and packing plants on week-ends. While he was unable to participate in the business activities, yet he discussed its problems with his father on these occasions. In December, 1943, Harkness, Jr. went overseas with the Air Corps and did not return to Fresno until January, 1946." (R. 269-271; 13 T.C. 1048-1049.)

7. *The findings with respect to the disposition of the childrens' share of the profits earned in 1943: Taxes and promissory notes are paid and the balance is carried in their accounts.*

"In 1943 United Packing Co. had gross proceeds of $2,572,905.53 and a net income of $361,582. In accordance with the terms of the supplemental agreement Harkness, Sr., was paid a

[6]The finding that Mrs. Colgate "did not participate in the management", is in the nature of an ultimate finding, and is contradicted by evidentiary findings which precede it showing that she was actually consulted with respect to major business transactions.

salary of $75,000 and Harkness, Sr., Molly Harkness, Harkness, Jr., and Harriet Colgate each were credited with $71,645.50 as their respective shares of the profits.

Harriet's credit on the partnership books was first applied to pay off the principal and interest on her promissory note to Harkness, Sr., in the amount of $35,942.82, and to offset prior withdrawals from her capital account consisting of cash in the amount of $112.97 and sums of $1,070.89 and $31,423.67 paid to the collector of internal revenue. The balance of $3,095.15 which she left in the business at the close of 1943 was withdrawn in 1944 to pay for taxes and personal expenditures. Of the $71,645.50 credited to Harkness, Jr., $34,495.08 was turned over to his father to pay the principal and interest on his promissory note. Of the remaining $37,150.42 which he left in the business in 1943, young Harkness expended $331.58 for his own use in 1944." (R. 271; 13 T.C. 1949-1050.)

B. The Evidentiary Facts.

8. *The obligations evidenced by the promissory notes were real, and enforceable against the children, irrespective of the success or failure of the partnership.*

Petitioners did not make gifts of interests in the partnership to their children; they enabled their children to purchase these interests. (R. 148-149.) The promissory notes executed by the children were unconditional promises to pay secured by their respective interests in the partnership. (R. 118-119,

Ex. 16; 120-121, Ex. 17.) Petitioners expected these notes to be paid regardless of the success or failure of the partnership business. (R. 190.)

9. *The nature of the partnership capital and the manner in which the partnership income was earned during 1943.*

The petitioners did not transfer to the partnership all the community assets of the sole proprietorship (R. 32; 111-113.) They retained as community assets and did not transfer to the partnership two ranches valued at $30,314.95, and cash in the sum of $50,609.48. (R. 112.) It was stipulated that these two ranches "were excellent producers". (R. 32.)

On January 1, 1943, the capital of the partnership consisted of cash in the sum of $100,000, personal property valued at $32,080.34, accounts receivable in the sum of $8,234.43 and real property valued at $2,546.28. (R. 25.)

It will be noted that while the sole proprietorship owned a substantial amount of income producing real property, the partnership had but little real property.

Early in 1943, the government issued an order prohibiting the use of grain for the manufacture of beverages having a high alcoholic content (R. 143). After this order became effective, the price of wine rose from $0.40 a gallon to $1.60 a gallon, and the price of grapes increased from $20 a ton to $140 a ton. (R. 143-44.)

In February, 1943, as the evidentiary findings show, the petitioners and their children acquired, as tenants

in common, an undivided one-half interest in a 300-acre ranch which had on it a vineyard and a plum (R. 269-270) orchard. This finding also shows that the other one-half interest was acquired by Sorenson, a supervisory employee of the partnership, and that all the funds for the purchase of the ranch were furnished by the partnership. This ranch had a book value of $64,290.59. (R. 52.)

Thereafter, this ranch was operated by petitioners and their children in partnership with Sorenson. (R. 131.) During 1943, in excess of 600 tons of grapes were delivered from this ranch to local co-operative wineries. (R. 52.) The plum crop raised on the ranch was also of value in the business of the partnership. (R. 139.)

In 1943 the total net income from this property was $120,619.84. (R. 52.) The share of this income accruing to petitioners and their children was $60,309.92.

In 1943, the partnership also acquired and operated another vineyard—a 40-acre piece. (R. 157-158.)

The record shows that in addition to Sorenson and petitioner, Harkness, Sr., the partnership had, in 1943, six other employees who received bonuses or shares of net profits in addition to salaries. (R. 53-54.) R. A. Northrop received $12,508.03, representing 50% of the profits derived from leases of tokay vineyards, and C. D. Wylie, received $11,634.63, or 50% of the net profits from the fruit shipping operations conducted at Arvin. (R. 54.) Sorenson, in addition to

his participation in the profits of the 300-acre ranch, received $53,283.59, or 25% of the net profits from the fruit shipping operations in the Clovis-Sanger district. (R. 54.)

10. *The events that occurred in 1944 and 1945: (a) Colgate renders services and becomes a fifth partner in the enterprise; (b) The partnership agreement is modified; (c) Sorenson's interest in the 300-acre ranch is acquired by petitioners and their children as tenants in common.*

In the fall of 1944, Harriet Colgate and her husband returned to Fresno and Colgate immediately went to work for the partnership. He worked under the supervision of Sorenson for a short period of time. (R. 129; 153; 217-218.) Thereafter, on January 15, 1945, when Sorenson left the employ of the partnership, Colgate became the fifth partner in the enterprise. This is evidenced by a supplemental agreement dated January 16, 1945. (R. 33, Ex. 2-B.) As of that date, Colgate and his wife each became the owners of an undivided one-eighth interest in the partnership. This supplement provided that Colgate would be employed as a field man, receiving for his compensation the usual field man's salary, and provided also that this arrangement with Colgate was to continue in effect until return of Harkness, Jr. (R. 38-39.)

During 1945 Colgate was placed in charge of the operations in the partnership in the Sanger-Clovis district and has ever since been in charge of the operations of the partnership in that district. (R. 218-222.)

11. *The events that occurred in 1946 and 1947: (a) Harkness, Jr., is appointed assistant manager; (b) Two supplemental agreements are entered into fixing the compensation of Colgate, Harkness, Jr., and Harkness, Sr.*

In January, 1946, Harkness, Jr., was discharged from the Army and returned to Fresno, and forthwith began to render services to the partnership. (R. 128-129; 230; 241.) On January 11, 1946, the partners executed another supplemental agreement. (R. 75, Ex. 8-H.) This supplement provided that Colgate should receive as compensation 25% of the net profits derived from operations in the Clovis-Sanger districts and 25% of the net profits derived from any other deals actively supervised by him. (R. 76.) Under the terms of this supplement, Harkness, Jr., was appointed assistant manager of all operations, and his compensation was fixed at 25% of the net proceeds of the partnership (R. 76). This supplement also reaffirmed the provision fixing the compensation of Harkness, Sr., at 75% of the first $100,000 of partnership income. (R. 77.) Harkness, Jr., has ever since January, 1946, continuously rendered services to the copartnership as assistant manager. (R. 230; 240-242.)

On January 24, 1947, the partners executed another agreement fixing the compensation of Harkness, Jr., Colgate and petitioner, Harkness, Sr. (R. 78, Ex. 9-I.) Under the terms of this supplement, it was agreed that during 1947 Colgate would receive the same compensation for 1947 as he had received in 1946; that Harkness, Jr., would be during 1947 assist-

ant manager and would receive as compensation 25% of the net profits of the partnership after payment of the compensation due Colgate, and it was likewise agreed that petitioner Harkness, Sr., should receive for the year 1947, as manager, 75% of the net income from the partnership up to $100,000 after payment to Colgate of his compensation. (R. 79-80.)

12. *The capital is increased and profits are distributed to the partners.*

Ex. "6-F" attached to the stipulation of facts (R. 55-68) accurately reflects the condition of the books of account of the partnership insofar as the capital accounts of the five partners are concerned. This exhibit shows that, whereas the partnership had a net worth of $138,241.61 at its inception, it had, as of December 31, 1947, a capital of approximately $260,000. This exhibit discloses that, as of December, 1944, from accumulated and undistributed profits earned in 1943, including profits from the 300-acre ranch, the partners made the following contributions to increase the capital of the partnership: petitioners, $60,879.19; Harkness, Jr., $30,439.50; and Harriet and William Colgate, $30,439.60.

Exhibit "6-F" also shows that, as of December 31, 1947, petitioners had as capital undistributed profits and salary payable to them $385,367.58, as compared to $105,688.12, for Harkness, Jr., and $121,650.11 for Harriet and William Colgate.

Exhibit "6-F" likewise shows that there has been a proportionate distribution of earnings to the members of the partnership. Harkness, Jr., withdrew

$121,484.51 from income, after taxes, of $225,695.26. Harriet Colgate and her husband during the period 1944 to 1947 withdrew $100,138.48 from an income, after taxes, of $223,171.01.

These withdrawals expressed in percentages, show that Harkness, Jr., withdrew 56.5% of income, after taxes, and that Harriet Colgate and her husband withdrew 47.6% of income, after taxes.

The foregoing is in substance the record which the Tax Court had before it when it made its ultimate findings.

The Tax Court, in its opinion, discusses the facts disclosed by its evidentiary findings and sets forth reasons in support of its ultimate findings. There is no discussion in the opinion of the evidence showing that in the years after 1943 the son and the son-in-law rendered substantial services to the partnership and that the children and the son-in-law withdrew substantial amounts by way of profits from the partnership.

This opinion discloses that the Tax Court has evolved a new test to be applied in family partnership cases—one that very closely resembles the old "vital services—original capital test" used in the first *Culbertson* case (*Culbertson v. Commissioner* (1947), (6 T.C.M. 692), and it was on the basis of this test that these cases were decided in favor of respondent. This test has been referred to as the "present conduct by all partners theory".[7]

[7]Tax Court Index Digest, 1942-1950, p. 608 (Commerce Clearing House, Inc. 1951).

This theory is premised on and derives all of its vitality from the Tax Court's definition of the term "present conduct". The term "present conduct" has been borrowed from this Court's majority opinion in *Culbertson,* where it appears but once (337 U.S. 743, 93 L. Ed. 1665). Under this theory, recognition for tax purposes will not be accorded to a partner whose capital has its origin in an intrafamily gift or loan if he does not participate in the "present conduct" of the business during the tax year. This follows logically from the Tax Court's definition of "present conduct".

"Present conduct", as defined by the Tax Court, requires that the partner seeking recognition either render services or perform managerial or supervisorial functions during the tax year. Genuine consultation with respect to major business decisions and discussion of the day-to-day problems of the enterprise do not measure up to the objective standards thus set up by the Tax Court (13 T.C. 1053). Nor are these objective standards met by a good faith delegation of managerial and supervisory functions. Therefore, when the control exercised over the business by the partners does not meet these standards, their capital contributions are disregarded, and it is concluded that no partnership existed. This definition also requires that the business objectives which motivated the formation of the partnership be ignored if they are not achieved during the tax year (13 T.C. 1051-1052). The word "intent" is frequently employed by the Tax Court in its opinion, but despite the use of

this word, it is impossible to determine whether the failure to meet the standards set up by the definition results in frustration or gives rise to a conclusive presumption of bad faith which vitiates the transaction. It may be properly assumed that intent actually plays no part in the conclusion reached by the Tax Court, inasmuch as the good faith performance of the partnership agreement in years subsequent to the one in question is not given any consideration.

The Tax Court, though it found that "some of the evidence in this proceeding is indicative of a valid family partnership" (13 T.C. 1051), decided there was no "present intent" to have a partnership during the tax year, "but rather an indefinite future plan to operate United Packing Co. as a genuine partnership" (13 T.C. 1054).

The Court of Appeals, though it found that "the evidence leaves little room for doubt that Harkness, Sr., had determined that ultimately there should be a partnership including the children", and held that the conduct of the parties in subsequent years "was as likely to show an intent respecting future conduct as one for present enterprise", affirmed the decisions of the Tax Court "for the reasons and upon the grounds stated in the opinion of the Tax Court".

Petitioners, for the reasons hereinafter stated, now seek review and reversal of the judgment of the Court of Appeals for the Ninth Circuit.

QUESTIONS PRESENTED.

The question herein, broadly stated, is whether the Court below misapplied the decision of this Court in *Commissioner v. Culbertson,* supra, in affirming the Tax Court's decisions that the partnership income attributed by the petitioners to their children as partners should be included in their gross income in 1943 as defined in Section 22(a) of the Internal Revenue Code.

This question may be stated in parts as follows:

1. Whether it must be concluded, as a matter of law, from the evidentiary facts and findings, that there was a bona fide intent that the children be partners in 1943 in the family business because "of contributions of capital of which they were the true owners, as we have defined that term in the *Clifford, Horst* and *Tower* cases" (337 U.S. 748, 93 L. Ed. 1668).

2. Whether the Court below departed from the decision of this Court in *Culbertson* when it decided that the parties had no intent to operate the business as a genuine partnership in 1943, without deciding the question whether the children were the true owners of the capital they contributed to the partnership in 1943.

3. Whether this Court's decision in *Culbertson* establishes that, before a partner can be recognized as the true owner of a capital contribution, which has its origin in an intrafamily loan, he must participate in the management of the business during the taxable year.

4. Whether this Court's decision in *Culbertson* establishes that a partner cannot be the true owner of the capital contributed to a partnership, which has its origin in an intrafamily loan, if managerial powers or controls over the partnership business are retained by the lender.

5. Whether the lower Court departed from this Court's decision in *Culbertson,* where this Court held that a partner is engaged in the present conduct of a partnership business if he contributes capital of which he is the true owner during the taxable year.

6. Whether the Court below departed from the decision of this Court in *Culbertson* when it decided the parties had no intent to operate the business as a bona fide partnership in 1943, without giving effect to the facts which occurred subsequent to the taxable year.

7. Whether the lower Court's definition of "present conduct", which requires that a partner seeking recognition on the basis of a capital contribution having its origin in an intrafamily loan, must either render services or perform managerial or supervisory functions during the tax year, is supported by this Court's decision in *Culbertson.*

8. Whether the lower Court's definition of "present conduct" restricts or is in conflict with the definition of "true owner" set forth in this Court's remand in *Culbertson.*

SPECIFICATIONS OF ERROR.

Petitioners submit that the Court of Appeals erred in the following particulars:

1. In holding contrary to the decision of this Court in *Commissioner v. Culbertson,* supra, that petitioners and their children had no *intent* to join together in conducting the family business as *bona fide* partners in 1943.

2. In affirming the decisions of the Tax Court.

REASONS FOR GRANTING WRIT.

1. **CONFLICT OF DECISION BETWEEN CIRCUITS.**

There is a basic conflict of decision between circuits with respect to the choice of the taxable person in cases involving intra-family transactions. This conflict exists because of fundamental differences of opinion with respect to the tax consequences that follow when the powers of management are delegated to the person with whom the property originated.

These differences do not arise in cases which may be harmonized because in one, capital has been transferred, while in others, merely the right to receive income has been given. Nor may the cases in which differences exist be reconciled on the ground that some show completed and unconditional transfers, while others disclose incomplete and conditional transfers. The cases in which these differences exist all involve technically complete transfers, and in which the element of "indian giving" is entirely absent.

The Court of Appeals for the Ninth Circuit has, by its decision in these causes, arrayed itself on the side of the Courts of Appeal, that take the position that income must be taxed to the person in whom the powers of management repose. This position was taken earlier by the Court of Appeals for the Fourth Circuit in *Feldman v. Commissioner* (1950), 186 F. (2d) 87.

This position has been rejected by the Court of Appeals for the Seventh Circuit in *Greenberger v. Commissioner* (1949), 177 F. (2d) 990, the Court of Appeals for the Tenth Circuit in *Visintainer v. Commissioner* (1951), 187 F. (2d) 519, and the Court of Appeals for the Fifth Circuit in *Alexander v. Commissioner* (1951), 190 F. (2d) 753.

The Courts of Appeal for the Fourth and Ninth Circuits regard the delegation of managerial powers either as frustration of the technically complete transfer of property, regardless of good faith intent, or as giving rise to a conclusive presumption of bad faith which likewise vitiates the transfer. On the other hand, the Courts of Appeal for the Fifth, Seventh and Tenth Circuits do not regard such a delegation of powers as having either of these effects. These Courts hold that if there is good faith, in the first instance, the powers of management are exercised as agent and not as principal or owner of the transferred property. The position of these Courts is concisely stated in the following taken from *Alexander v. Commissioner,* supra (190 F. (2d) 755-756):

"We find in the father's vicarious management of the property for his son nothing which justifies visiting the tax consequences of the enterprise upon the father as the 'earner' of the income. There is a distinction between managerial control over income producing property with the consent of the actual owner, and the absolute right of control over both the property and the income derived therefrom which inheres in a valid legal title. The Tax Court failed to observe that distinction here.

"As the son was the owner of the property and unconditionally entitled to receive and enjoy the income in question, the son, not the father, is taxable therefor. The deficiency assessments in question should each be set aside."

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2. THE DECISION OF THE COURT OF APPEALS HEREIN MISAPPLIES THIS COURT'S DECISION IN THE CULBERTSON CASE.

Petitioners admit that their children did not render services during the tax year. They also admit that their children did not contribute "original" capital, except for the small credit which the son had on the books. Accordingly, their contention that the Court of Appeals misapplied this Court's decision is based solely on the ground that their children were the "true owners" of the capital they contributed to the partnership, as this term is defined in *Helvering v. Clifford* (1940) 309 U.S. 331, 84 L.Ed. 788, *Helvering v. Horst* (1940) 311 U.S. 112, 85 L.Ed. 75, and *Commissioner v. Tower* (1946) 327 U.S. 280, 90 L.Ed. 670.

(*Culbertson v. Commissioner,* supra, 337 U.S. 748, 93 L.Ed. 1668.)

In considering petitioners' contention, it should be observed that there is not here, as there was in the first *Culbertson* case, documentary proof which without ambiguity disclosed an intent that the children were to "acquire an interest in the business in the *future*" (6 T.C.M. 700), and, therefore, clearly contradicted the claim that it was intended that the children be partners in the *present.* Therefore, in the first *Culbertson* case a finding could be made to the effect that there was no *present* intent for a partnership but only an indefinite future plan to operate as a partnership. Such a finding cannot be made in this case.

Here we do not have, as in *Clifford,* a short-term trust, where, under the trust instrument, the trustor could recapture the donated capital *without cost to himself,* and there are no exculpatory clauses such as appear in that instrument. The distribution of income and the investment of capital is not, as in *Clifford* in the "absolute discretion" of petitioners. Here, contrary to what appeared in *Clifford,* we have an unconditional conveyance of partnership interests, and an agreement through which Harkness, Sr., surrendered his exclusive and extensive powers as manager of the community. This Court has ruled that the surrender of these powers over property has such an effect on the economic status of the parties as to "furnish appropriate occasions for the imposition of an excise tax" (*Fernandez v. Wiener* (1945) 326 U.S. 340, 355.

90 L.Ed. 116, 130). Petitioners, unlike Mr. Clifford, are not as rich as they were before the making of the partnership agreement, because they are unable without cost to themselves to recapture what they sold. It is impossible to say here, as could be said in *Clifford,* that there has been merely a temporary reallocation of income. The record shows substantial withdrawals of partnership income by way of distributed profits and salaries by the children.

The situation here is not as in *Lucas v. Earl* (1930) 281 U.S. 111, 74 L.Ed. 731. There the assigned income was derived from personal services only. The income in this case is derived from income-producing property and from services rendered by a well compensated manager and other employees.

In *Horst* income from invested capital was assigned, but not the capital. Contrary to what occurred in *Horst,* the petitioners herein transferred capital, not income. Here, the children, like the respondent in *Horst,* enjoyed the fruits of their investment, because they employed their distributive share of the income to liquidate the indebtedness they had incurred in purchasing their partnership interests.

In *Commissioner v. Tower,* supra, and in *Lusthaus v. Commissioner* (1946) 327 U.S. 293, 90 L.Ed. 679, the record shows conditional gifts or loans of capital, and passive acquiescence by the alleged partners to the terms dictated by the dominant partners. In this case the evidentiary findings show that the "son eagerly accepted the chance to buy an interest", and that the Colgates "debated at length" whether to buy an in-

terest or "invest elsewhere". The findings also show that the daughter refused to sign the agreement until it was modified to meet her demands. In this case the evidentiary findings show that good and sufficient business reasons motivated the formation of the partnership, while in *Tower* and *Lusthaus* the record makes it evident that the partnership served no business purpose.

Here, as contemplated by *Culbertson,* the children influenced the conduct of the business by their counsel. And their contributions of capital and services in later years disclose *bona fide* performance of the terms of the agreement, and fulfilment of the purposes which motivated the formation of the partnership.

The record, viewed in the light of the authorities above discussed, shows that the Court of Appeals definitely misapplied this Court's decision in *Culbertson.* The Court of Appeals declares that its decision herein results from the application of the subjective tests ordained in *Culbertson.* This is not so. The decision herein results from the application of objective tests derived from a definition of "present conduct" which is entirely out of harmony with this Court's concept of "true owners".

The reasoning of the Court of Appeals herein is as follows:

The children did not exercise immediate supervision over the partnership and did not contribute original capital. Therefore, we find that the children were not "true owners" of the capital contributed and that the parties did not intend to be *bona fide* partners.

In the pre-*Culbertson* era, the same proposition could be stated without the use of the word "intent". Surely, this Court's decision in *Culberston* was not meant to be only an invitation to employ the word "intent" to give apparent validity to the use of the rejected formula. (*Bruton, "Family Partnerships and the Income Tax—The Culbertson Chapter"*, (1949) 98 U. of Pa. Law Review 143, 156-157.)

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3. THE DECISION OF THE COURT OF APPEALS HEREIN DECIDES AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.[8]

It had been hoped that this Court's decision in *Culbertson* would definitely settle the confusion created by the misapplication of the principles set forth in *Commissioner v. Tower* and *Lusthaus v. Commissioner*. This hope has not been realized.

The important question which is determinative of the choice of the taxable person in intrafamily transactions is still open and unsettled. Stubborn adherence to the discredited "vital services—original capital" test in decisions couched in *Culbertson* language is responsible for this result and has led to great confusion in the administration of the Federal Revenue Laws. That confusion exists, and that the important question that gives rise to it has not been

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[8]In this case, as in many others, the line between an unsettled question and possible misapplication of prior decisions is shadowy and for this reason we feel justified in appealing to this Court's discretion under both the fourth and fifth reasons stated in Rule 38.

settled has been recognized by Congress, the Commissioner of Internal Revenue and by others having an interest in the subject. The expressions of opinion hereinafter set forth furnish ample proof of this fact.

The House Committee Report accompanying the Revenue Act of 1951 states:

> "* * * Many court decisions since the decision of the Supreme Court in *Commissioner v. Culbertson* (337 U.S. 733) have held invalid for tax purposes family partnerships which arose by virtue of a gift of a partnership interest from one member of a family to another, where the donee performed no vital services for the partnership. Some of these cases apparently proceed upon the theory that a partnership cannot be valid for tax purposes unless the intrafamily gift of capital is motivated by a desire to benefit the partnership business. Others seem to assume that a gift of a partnership interest is not complete because the donor contemplates the continued participation in the business of the donated capital. However, the frequency with which the Tax Court, since the Culbertson decision, has held invalid family partnerships based upon donations of capital, would seem to indicate that, although the opinions often refer to 'intention,' 'business purpose,' 'reality,' and 'control,' they have in practical effect reached results which suggest that an intrafamily gift of a partnership interest, where the donee performs no substantial services, will not usually be the basis of a valid partnership for tax purposes. We are informed that the settlement of many cases in the field is being held up by the reliance of the field offices of the Bureau of Internal Revenue upon some such theory.

> Whether or not the opinion of the Supreme Court in *Commissioner v. Tower* (327 U.S. 280) and the opinion of the Supreme Court in *Commissioner v. Culbertson* (337 U.S. 733), which attempted to explain the Tower decision, afford *any justification for the confusion is not material—the confusion exists.*" (Italics supplied.)
>
> House Rep. No. 586, 82d Cong., 1st Session, pp. 32-33.

A recent mimeograph issued by the Commissioner, contains the following:

> "*This mimeograph is designed to clarify the position of the Bureau with respect to some aspects of the family partnership problems for taxable years beginning prior to January 1, 1951, concerning which there appears to be uncertainty.* In one way or another the aspects of the problem that will be discussed have to do with the question whether an alleged partner is the real owner of an interest in the capital of a partnership which is attributed to him. *This mimeograph is applicable only to cases in which capital is a material income-producing factor.*" (Italics supplied.)
>
> Com.-Mim., Coll. No. 6767, Feb. 19, 1952, p. 1.

In a Law Review note, this comment appears:

> "The disparity in judicial result serves to cast doubt upon the guidance value of the *Culbertson* decision."
>
> "*Income Taxation of Family Partnerships*" (1950), 50 Col. Law Rev. 68, 76.

A study of cases decided by the Tax Court after the decision in *Culbertson* led to this conclusion:

"In conclusion, we find that the effect of *Commissioner v. Culbertson* upon the status of the family partnership is not too well defined at this date. The lack of unanimity in *Theurkauf*—six judges joined in the dissenting opinion—indicates definitely different viewpoints within the court. This and the decision in *Harmon* and the dissent therefrom create some doubt that a well-defined rule for application of the *Culbertson* case has been formed."

Murphy, "What Is the Present Status of the Family Partnership? Where Does Culbertson Leave Us? New York University, 8th Annual Institute on Federal Taxation, 1070, 1078-1079 (Bender, 1950).

Congress intended by the enactment of Section 191 of the Internal Revenue Code to "harmonize the rules governing interests in * * * family partnerships with those generally applicable to other forms of property or business" (H.R., supra, p. 32). However, as this statute leaves the Courts free to inquire in any case whether the donee or purchaser actually own an interest in the partnership (H.R., supra, p. 33), the declared intent of Congress can be defeated by recalcitrant Courts through decisions such as those involved in these cases. We believe this furnishes an additional reason for granting the writ herein.

The clarification attempted by the Commissioner in his mimeograph adds to the confusion. For instance, without any warrant in law, the Commissioner announces that in cases where an interest in a family partnership is acquired through a loan or credit ex-

tended by a family member, and the purchaser or borrower has insufficient means or credit standing, the transaction may be regarded as a gift, subject to deferred enjoyment until the obligation has been paid (Com.-Mim., supra, p. 6). This erroneous administrative interpretation furnishes another reason for the grant of the writ.

Finally, we submit that the writ should be granted because the foregoing shows that in an important field of law we have arrived at a point where it can be fairly said that:

> "There are no such things as rules or principles: there are only isolated dooms."[9]

Wherefore, petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit.

Dated, San Francisco, California,
March 12, 1952.

Respectfully submitted,

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[9]Cardozo, "The Nature of the Judicial Process", p. 126 (1921, Yale University Press).

(Appendix Follows.)

Appendix

Internal Revenue Code:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

(26 U. S. C. A., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. A., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. A., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U. S. C. A., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * * * *

(26 U. S. C. A., Sec. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1951

Nos. 650 and 651

MOLLY A. HARKNESS,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

FLOYD J. HARKNESS,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

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To the Honorable Fred M. Vinson, Chief Justice of the Supreme Court of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

The purpose of this Supplement to our Petition for Writ of Certiorari is to bring to the attention of

the Court two recent decisions of the Court of Appeals for the Fifth Circuit. These decisions came to the attention of counsel for petitioners after the petition had been filed.*

These cases serve to further show that there is a basic conflict of decision between Circuits with respect to the choice of the taxable person in intra-family transactions. Petitioners, therefore, respectfully request that these cases be considered by the Court under the first reason given in the Petition for granting the Writ, to wit, conflict of decision between Circuits.

On March 6, 1952, the Court of Appeals for the Fifth Circuit issued its decisions in the cases of *Culbertson v. Commissioner,* 194 F. (2d) 581, and *Alexander v. Commissioner,* 194 F. (2d) 921.

This latest *Culbertson* decision is the fourth made in connection with the family partnership income tax case involving Mr. and Mrs. W. O. Culbertson and their four sons. The Tax Court, after the case was remanded to it by this Court, re-examined the record, took additional evidence and found, contrary to the contentions of the Culbertsons, that it was not the intention of the Culbertsons "and their sons, or any of them, in good faith to become partners in the cattle business during the taxable years 1940 or 1941" (*Culbertson v. Commissioner,* 9 T.C.M. 647, 651-652 (1950)). This ultimate finding was based on the following evidentiary findings:

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*The petition herein was filed on March 14, 1952.

1. (a) W. O. Culbertson, Jr., rendered services during the tax years in question, but did not perform any managerial functions (9 T.C.M. 648, 656); (b) Richard Culbertson was either at Texas A. & M. or in the Army and rendered no services whatsoever (9 T.C.M. 649, 656); (c) Eugene and Joe Jack Culbertson were going to school and did routine farm or ranch work on weekends (9 T.C.M. 649, 656).

2. Petitioner, W. O. Culbertson, Sr., had the general management and control of the business (9 T.C.M 648-650, 656).

3. Conditional conveyances of partnership property were made by the Culbertsons to their sons, and for this reason the sons did not contribute capital of which they were the true owners to the partnership (9 T.C.M. 651).

When the case came up for review for the second time before the Court of Appeals, that Court did not take issue with the first and second evidentiary findings above set forth, but decided that the record did not sustain the third finding and found that the Culbertson boys were the true owners of the capital contributed by them to the partnership. Accordingly, the decision of the Court of Appeals is authority for the proposition that children may be accorded recognition as partners for tax purposes if they are the true owners of the capital contributed, even though they do not render managerial or supervisorial services and the powers of management are retained by the person in whom the capital contributions originated. We, therefore, submit that this latest decision

in the *Culbertson* case is squarely in conflict with the decision of the Court of Appeals for the Ninth Circuit in this case.

The *Alexander* case, supra, involves a gift of agricultural property and cattle to the minor daughter of the petitioner. The daughter did not operate her properties and they were managed by the petitioner. The Commissioner determined and the Tax Court decided that the income derived from the capital and the property should be taxed to the petitioner because he managed the property. The Court of Appeals reversed the Tax Court on the ground that since the daughter owned the property, she was also the owner of the income derived therefrom, even though the petitioner performed managerial services on her behalf. It is respectfully submitted that this case is also in conflict with the decision of the Court of Appeals for the Ninth Circuit herein.

Dated, San Francisco, California,
April 25, 1952.

Respectfully submitted,
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